

STAFF PAPER

Week of 19 November 2012
FASB | IASB Meeting

FASB Education Session 14-15 November 2012

Project	Revenue Recognition		
Paper topic	Implementation guidance: Licenses		
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Purpose of paper

1. This paper considers potential improvements to the implementation guidance for licenses that was proposed in the 2011 Exposure Draft *Revenue from Contracts with Customers* (“2011 ED”), specifically:
 - (a) determining the nature of the entity’s promise in a license arrangement; and
 - (b) clarifying how the revenue model would apply to license arrangements.
2. This paper should be read in conjunction with Agenda Paper 7G/164G *Implementation guidance: licenses – illustrative examples*. That paper considers the application of the potential improvements outlined in this paper.

Staff recommendation

3. The staff recommend that the nature of the promise in a license is a promise to transfer a right (ie View A in this paper or the 2011 ED proposals). This is because in the staff’s view, View A is simpler to apply than View B and View C. Furthermore, View A will ultimately result in similar outcomes as View B for

most license arrangements (and View C for some license arrangements) when the other parts of the revenue model are applied (see Agenda Paper 7G/164G).

4. The staff also recommend clarifying the application of the revenue model to license arrangements as described in paragraphs 35-45.

Structure of paper

5. This paper is organised as follows:
 - (a) Background (paragraphs 6-8)
 - (b) Staff analysis (paragraphs 9-31)
 - (i) What is the nature of the promise in a license? (paragraphs 11-13)
 - (ii) View A (paragraphs 14-17)
 - (iii) View B (paragraphs 18-25)
 - (iv) View C (paragraphs 26-31)
 - (c) Staff recommendation (paragraphs 32-34)
 - (d) Applying other parts of the revenue model (paragraphs 35-45)
 - (i) Step A (paragraph 38)
 - (ii) Step B (paragraphs 39-40)
 - (iii) Step C (paragraphs 41-42)
 - (iv) Applying the constraint (paragraph 43-45)
 - (e) Bringing it all together (paragraphs 46-48)
 - (f) Appendix A: Suggested improvements to the implementation guidance

Background

6. At the July 2012 joint Board meeting (Agenda paper 7D/161D), the Boards discussed feedback on, and proposed clarifications to, the implementation guidance for licenses in paragraphs B33—B37/ IG33—IG37 of the 2011 ED.

Those clarifications were suggested to address the feedback that a number of respondents:

- (a) seemed to misunderstand the implementation guidance because they thought that it meant that all license arrangements would result in revenue being recognised at a point in time;
- (b) disagreed with the conclusion that (in principle) a performance obligation to transfer a license was satisfied at a point in time (however, were unclear about what the performance related to a license represented); and
- (c) had difficulty applying the model to licenses, specifically identifying separate promises in a contract and determining whether the license is distinct.

7. The July Agenda paper 7D/161D suggested clarifying in the implementation guidance that not *all* agreements that include a license would result in revenue being recognised at a point in time, but rather an entity would need to assess the terms of the agreement and apply the principles in the 2011 ED to determine the amount and timing of revenue recognition. For example, an entity would recognise revenue over time in a license arrangement if the entity had promised other goods or services in the contract and the license is not distinct from those additional goods or services.
8. No decisions were made at the July 2012 joint Board meeting. Instead, the staff were directed to consider whether a license, absent other performance obligations in the contract, would always “give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights” (as proposed in paragraph B34 of the 2011 ED). Some Board members continued to support the conclusion in paragraph B34 because they thought that when other parts of the revenue model were applied to license arrangements, the amount and timing of revenue recognition would appropriately reflect an entity’s performance. However, other Board members thought that, in many cases, the nature of an entity’s performance obligation in a license is more like a service (ie a

performance obligation satisfied over time). Thus, the transfer of a license should result in revenue being recognised over time, regardless of whether that license was bundled with other goods or services that transfer to the customer over time.

Staff analysis

9. A license is a contractual mechanism that establishes the customer's rights related to the intellectual property of the entity and the obligations of the entity to provide those rights. Some respondents and Board members have observed that there are significant differences in licenses based on when and how those rights transfer to the customer and when the entity satisfies its obligations. Therefore, like other contracts, the timing of the transfer of resources may differ for different types of licenses. However, often, the timing of the transfer of resources may differ because of promises in the contract *in addition* to the promise to transfer a license.
10. Reconsidering the nature of the entity's performance obligation or, more specifically, the entity's *promise* related to the license, is only one part of the analysis of determining when revenue should be recognised for a license arrangement. This is because other features of the license arrangement—for instance, the existence of other promises or variable consideration—could affect the amount and timing of revenue recognition as a result of applying other parts of the revenue model (for example, identifying separate performance obligations and constraining the cumulative amount of revenue recognised). Therefore, in assessing whether the pattern of revenue recognition for license arrangements is appropriate, the staff think that it is important to consider the application of all the principles of the revenue model. This paper first considers the nature of the entity's promises related to the licenses before considering the application of other parts of the revenue model.

What is the nature of the promise in a license?

11. The 2011 ED defined the promise in a license as a promise to provide a right to use, but not own, intellectual property of the entity. However, paragraph BC315(b) acknowledged an alternative view for the nature of the entity's promise related to a license as follows:

A license represents access to the entity's intellectual property that the entity satisfies continuously over the pattern of use of the underlying rights to use the entity's intellectual property by the customer.

12. In other words, this alternative view in paragraph BC315(b) acknowledges that licenses may represent a promise to provide a service (ie a promise to transfer an asset over time). After analysing the issue further, the staff have developed three alternative views to determine the nature of an entity's promise in a license. Those views are outlined in the table below.

	View A (2011 ED proposals)	View B	View C
<i>Nature of the entity's promise in a license is to provide</i>	A right	A right <i>when specified indicators are met, otherwise it is:</i> Access to the entity's intellectual property	Access to the entity's intellectual property; <i>unless</i> the terms of the license give the customer control of the underlying intellectual property, such that the entity has in effect sold that intellectual property.

13. As discussed above, determining the nature of the promise in a license is only one part of determining when revenue should be recognised for a license arrangement. Paragraphs 35–45 below discuss the application of the other parts of the revenue model to license arrangements.

View A (2011 ED proposals)

14. View A is based on the 2011 ED proposals which defined the promise in a license as the promise to provide a right. Notwithstanding that the right defined by the license (ie the promised asset) may, in some cases, represent a right to use only a portion (defined by time, geography, exclusivity, etc.) of the underlying intellectual property, that right represents a separate asset that can be transferred by the entity and controlled by the customer. Therefore, upon transfer of this right (typically at the inception of a license arrangement) the customer can direct the use of, and obtain substantially all of, the remaining benefits from the right (ie the customer can determine how and when to use the right and, thus, when the benefits from the asset can be consumed). This is consistent with the leases project where the lessee obtains control of the right of use asset at the inception of the lease agreement. However, the staff note that an important difference between a lease and a license is that because the underlying intellectual property in a license is intangible and thus divisible, the customer does not obtain any part of the underlying intellectual property beyond the portion defined by the license. Thus, in the staff's view, accounting for a license need not consider any residual because there is nothing to be returned to the entity at the end of the license arrangement.
15. Under View A, because the nature of the promise is to provide a right, an entity could not conclude that the promise represents a performance obligation satisfied over time because none of the criteria in paragraph 35 of the 2011 ED could be met. This is because the entity's performance is not creating an asset controlled by the customer as it is created—in most licenses, the intellectual property already exists. (However, the staff observe that in some contracts where the entity is providing a service of development of intellectual property, for example in software development contracts, the entity *is* creating an asset that may be controlled by the customer as it is created.) Furthermore, the transfer of a right is more akin to a good than a service and, therefore, upon transfer of the right the entity's performance is complete. The entity would therefore assess when control

transfers based on the indicators of control in paragraph 37 of the 2011 ED, which would typically be at the inception of the license arrangement.

16. Although current practice in accounting for licenses is quite mixed, View A is consistent with the tentative decisions in the leases project and broadly consistent with the principles in many existing standards in US GAAP. For example Subtopics 985-605 *Software*, 952-605 *Franchisors*, 926-605 *Entertainment-Films*, 928-605 *Entertainment-Music* require revenue to be recognised at a point in time when specified criteria are met, such as the rights have been delivered, material services are substantially performed, and the fee is determinable. Similarly, the illustrative examples of IAS 18 *Revenue* suggest that a fixed fee license where the entity has no further performance obligations would result in revenue recognised at a point in time (ie like a sale of an asset or product). However, each US GAAP subtopic and IAS 18, as well as SEC guidance related to licenses, suggest some circumstances where revenue should be recognised over time, primarily because of measurement uncertainty, collectibility concerns, or the existence of additional services, such as, for example, unspecified additional software products (paragraph 985-605-25-58). These circumstances would be addressed by other parts of the revenue model.
17. However, View A may differ from some practical guidance in IAS 18 and in Subtopic 985-605 that permits revenue to be recognised over time for the entire license arrangement. In particular, IAS 18 indicates that revenue would be “recognised in accordance with the substance of the agreement,” which “as a practical matter...may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time” (IAS 18 Illustrative Examples, paragraph 20). Furthermore, Subtopic 985-605 permits software entities to avoid assessing whether an initial license would represent a separate deliverable and, thus, require an allocation of consideration, when the license arrangement includes a promise to deliver unspecified additional software products in the future or post contract customer support and that is the only undelivered item in the arrangement.

View B

18. View B expands View A (and the 2011 ED proposals) and acknowledges that the timing of the transfer of resources may differ for different types of licenses (absent other promises in a contract). In particular, although some licenses represent a promise to provide a right, other licenses represent a promise to provide access to the entity's intellectual property. View B therefore acknowledges that the two alternative views of the nature of an entity's promise in a license outlined in paragraph BC315 may be appropriate for different types of licenses.
19. These licenses may be distinguished based on the nature of the promised asset in the license. For example, in View B, the promised asset in licenses that provide a right may be an output that results from (ie is produced by) the entity's intellectual property. This right is therefore similar to other tangible goods, however, it is transferred in the form of a license because of the intangible nature of the underlying intellectual property. This may be the case in some software, music or movies (eg DVDs). In these cases, the output can be reproduced with little effect on the value of the underlying intellectual property or the entity's ability to issue additional licenses. Furthermore, the customer can determine how and when to use the right (that is when the benefits from the asset can be consumed), and the customer does not require any further performance from the entity to be able to consume those benefits.
20. However, for other licenses that represent a promise to provide access to the entity's intellectual property, the promised asset is the service of access. In these cases, access to the underlying intellectual property is required because the customer obtains a right to use only a portion of the underlying intellectual property (defined by the terms of the license) and that portion is closely connected to the remaining underlying intellectual property. This may be evidenced by the fact that changes in the nature or value of the underlying intellectual property may directly affect the portion that the customer has a right to use by virtue of the license. An example would be a license to use a brand or a trademark in a specific country or for a specific time, whereby the underlying intellectual property may

change as a result of actions of the entity to maintain the value of the intellectual property or extend its useful life. In these cases, the customer does not obtain control of a portion of the entity's intellectual property at the inception of the license. Rather, the customer obtains benefits from the entity only over time as the access is provided to the intellectual property. Importantly, when determining whether a license represents a promise to provide access, an entity would not consider other promises in the contract that either specifically provide access to the licensed asset (such as software hosting) or that may change the nature of the asset defined by the license, such as when-and-if-available updates or specific promises of advertising. These promises would be assessed under other parts of the model and may be assessed as separate performance obligations or may need to be bundled with the license because one or more promises are not distinct.

21. To determine whether the license represents a promise to provide a right or a promise to provide access, the staff think that the implementation guidance should provide indicators of when the license may represent a promise to provide a right. When these indicators are not met, an entity would conclude that the license represents a promise to provide access. Using the characteristics in paragraph 19, these indicators could be as follows:
 - (a) The right transferred to the customer in the form of a license represents an output of the entity's underlying intellectual property, similar to a tangible good.
 - (b) The license can be easily reproduced by the entity with little or no effect on the value of the underlying intellectual property.
 - (c) The customer can determine how and when to use the right (that is when the benefits from the asset can be consumed) and the customer does not require any further performance from the entity to be able to consume those benefits.
22. Determining whether the nature of the promise in a license represents a promise to provide a right or a promise to provide access will affect whether the transfer of a license (absent other promises in the contract) represents a performance obligation

satisfied at a point in time or over time. As explained above in View A, when the promise in a license represents a promise to provide a right, the performance obligation would be satisfied at a point in time because the criteria in paragraph 35 of the 2011 ED would not be met. However, when the promise in a license represents a promise to provide access to the underlying intellectual property, the performance obligation would be satisfied over time because the criterion of the “customer simultaneously receives and consumes the benefits of the entity’s performance as the entity performs” (paragraph 35(b)(i) of the 2011 ED and tentative decision of the Boards in July 2012) would be met.

23. Because View B results in the recognition of revenue over time for some licenses, the staff think that this view would be responsive to those Board members and respondents who thought that, for some licenses, revenue should be recognised over time (regardless of other promises in the contract). This is because, in their view, recognising revenue over time for some licenses would be more representative of the pattern of transfer of resources from the entity to its customer. In addition, View B acknowledges the diversity of license arrangements by differentiating the accounting for those arrangements based on the nature of the promised asset.
24. However, by adding another step of analysis in determining when to recognise revenue in a license arrangement, View B adds complexity. Furthermore, by trying to differentiate the nature of the promises inherent in a license, View B may be difficult to operationalize. This may be because some may find it difficult to see a distinction between a license that promises to transfer a right and those licenses that promise to provide access, because in both cases the customer is receiving the same thing—a right to use the entity’s intellectual property.
25. After considering the application of the other parts of the revenue model, View B will result in similar outcomes with View A for many license arrangements. While both views may result in a change in practice in the amount and timing of revenue recognition related to license arrangements because of variations in current practice, the staff think that View B may change practice in some industries where existing guidance or practice is clear and fairly consistent. For

example, franchisors currently recognise revenue at a point in time for the initial transfer of rights under a franchise agreement. However, in these cases, View B may require revenue to be recognised over time. (See Agenda Paper 7G/164G that outlines the effects of applying each view to various examples.)

View C

26. In View C, a license represents a promise to provide access to the entity's intellectual property (consistent with BC315(b)). This is because the intellectual property does not transfer to the customer but rather remains with the entity and, therefore, for all licenses, the customer is simply 'renting' a portion of the intellectual property. Thus, in View C, the customer is unable to control the portion of the intellectual property (defined by the license) at the inception of the license arrangement, but rather the customer obtains the benefits over time as access is provided by the entity. However, in some cases, the terms of the license may effectively give the customer control of all (or substantially all) of the remaining economic benefits of the underlying intellectual property such that the entity has, in effect, sold that intellectual property. This may occur when:
- (a) the license term is for substantially all of the remaining estimated useful life of the underlying intellectual property; or
 - (b) the underlying intellectual property will substantially diminish in value over the term of the license (ie the underlying intellectual property that is subject to the license will be obsolete at the end of the license term). This may be evidenced by the inability of the entity to grant similar licenses for the underlying intellectual property at the end of the license term.
27. In making this assessment, an entity should consider the underlying intellectual property that is subject to the license, rather than the knowledge that may be the basis for the underlying intellectual property (eg an entity would consider the copy of the software program as the underlying intellectual property, rather than the source code).

28. In View C, unless the term of the license effectively gives the customer control of all of the underlying intellectual property, the nature of the promise (ie to provide access) will, like in View B, mean that the performance obligation to transfer the license would be satisfied over time. However, when the terms of the license give the customer control of the underlying intellectual property, the performance obligation will be satisfied at the point in time that the customer obtains control of the license, based on the indicators of control in paragraph 37 of the 2011 ED (which would typically be at the inception of the license arrangement). Consider the following examples:

Example 1:

The entity grants a 2 year term license to a TV network to air seasons 1 and 2 of TV show X. The entity expects that the remaining useful life of the TV show is approximately 5 years and the entity will be able to re-license the show at the end of the 2 year term (that is the underlying intellectual property will not diminish in value during the license term).

Conclusion: The entity has promised to provide access to its underlying intellectual property and, thus, the entity has a performance obligation satisfied over time.

Example 2:

The entity grants a perpetual license to a TV network to air seasons 1 and 2 of TV show X in the United Kingdom.

Conclusion: The terms of the license transfer control of the underlying intellectual property to the customer. Therefore, the entity has a performance obligation satisfied at a point in time.

29. Some respondents may appreciate that View C will result in revenue for most licenses (absent other promises in the contract) being recognised over time. However, recent discussions with other respondents have indicated they are concerned that View C may result in revenue being recognised over time for some licenses where, in their view, the entity has no further performance obligations. Therefore, some have questioned how View C is consistent with the revenue model that focuses on the satisfaction of performance obligations. This was

similar to responses received on the 2010 ED where most respondents rejected differentiating the accounting for licenses based on the exclusivity of the promised rights to the intellectual property. In particular, one respondent to the 2010 ED explained that, in their view:

...an entity has either transferred to the customer the right to use that intellectual property for a period or it has not. If that right has been transferred, then it seems to us a contradiction in terms to say that the entity satisfies over time a performance obligation to permit the use of the intellectual property – on the contrary, that permission was transferred at the outset. (Deloitte, Comment Letter #393)

30. In addition, the staff observe that determining whether the terms of the license represent a significant portion of the underlying intellectual property will require a forward-looking assessment. This may be challenging in many cases related to intellectual property because the assets are typically not recognised in the financial statements and, furthermore, the value or useful life of the underlying intellectual property may be significantly affected by factors outside the entity's control, such as new technology or other market forces such as demand. Furthermore, even if the useful life is known, the assessment of the nature of the promise and, thus, ultimate pattern of revenue recognition may depend on when in the life-cycle of the intellectual property an entity grants the license. Consider the following examples:

Example 3:

A 5 year term license granted in year 5 of intellectual property that has an expected life of 20 years.

Conclusion: The term of the license does not represent substantially all of the remaining estimated useful life of the underlying intellectual property and, thus, the license represents a promise to provide access to its underlying intellectual property.

Example 4:

A 5 year term license granted in year 15 of intellectual property that has an expected life of 20 years.

Conclusion: The term of the license represents substantially all of the remaining estimated useful life of the underlying intellectual property and, thus, the license represents a sale of a right.

Comparing View B and View C

31. Although both View B and View C may result in revenue being recognised for some licenses (absent other promises in the contract) at a point in time and some over time, the rationale is different. Specifically, View C focuses on the relationship between the portion of the asset subject to the license and the underlying intellectual property. However, View B focuses on the nature of the asset and how the promise in the license arrangement may define an entity's performance obligation related to the transfer of a license.

Staff recommendation

32. The staff acknowledge that there are many different types of licenses and differences in when license arrangements transfer resources to the customer (and, thus, when revenue can be recognised). However, in the staff's view, those differences can only adequately be considered by applying *all* steps of the revenue model. This is because, in many license arrangements, the license will not be separable from other promises in the arrangement or the transaction price may be constrained such that the pattern of revenue recognition will be over time, regardless of the starting point for the nature of the promise related to the license (ie regardless of whether the nature of the promise is defined as outlined in View A, B, or C). Therefore, although the staff see merit in View B due to its acknowledgement of the diversity of licenses, it seems to add unnecessary complexity and may be difficult to operationalize. Furthermore, while View C may seem easier to operationalize, it too adds complexity and requires forward-looking assumptions. In addition, some have questioned whether it is appropriate

in View C to assume that most licenses represent a service of access because, in many cases, an entity has no further obligations beyond the transfer of the license. The staff also think that there is a risk that some may try to extrapolate the basis for View C to the lessee model and, therefore, challenge the conclusions in that project that a lessee obtains control of a right-of-use asset at lease commencement and accordingly recognises an asset and liability.

33. Therefore, **the staff recommend View A**—the license represents a promise to provide a right (which is consistent with the 2011 ED proposals). In the staff’s view, View A is simpler to apply than View B and View C, and will often ultimately result in similar outcomes when the other parts of the revenue model are applied (see further discussion below and Agenda Paper 7G/164G). The staff also observe that current practice for recognising revenue in license arrangements is quite mixed and, therefore, any view may result in a change in practice for some.
34. The staff note that although some disagreed with the approach in the 2011 ED (View A), many preparers and auditors supported View A in both comment letters and through outreach completed subsequent to the July 2012 joint Board meeting. In addition, the staff observe that some of the respondents that disagreed with the 2011 ED may have misunderstood the proposals and interpreted those proposals to mean that *all* of the transaction price related to a license arrangement would be recognised upon transfer of the license, irrespective of the pattern of transfer of other promises in the contract.

Applying the other parts of the revenue model to licenses

35. As discussed above, the nature of the promise in a license would be determined independently of applying other parts of the revenue model. The most relevant other parts of the model would be applied to licenses as outlined in the July Agenda paper 7D/161D and the supplement to that paper as follows:

Step A: In addition to the license, has the entity promised to transfer other goods or services to the customer?

Step B: Is the license distinct from the other goods or services promised in the contract?

Step C: When is the promise to transfer the distinct bundle of goods or services satisfied?

36. In addition, although it was not discussed in the July agenda paper, an entity would also need to consider how the constraint on the cumulative amount of revenue recognised should be applied to the consideration promised in the arrangement.
37. The staff recommend that these steps should be clarified in the implementation guidance for licenses.

Step A – Assessing other goods or services

38. When assessing whether the contract includes a promise to transfer other goods or services, an entity should consider other promises to undertake activities. However, those activities will represent a performance obligation only when they either transfer a good or service to a customer or create a valid expectation of the customer that the entity will transfer a good or service (paragraph 24 of the 2011 ED). Furthermore, those activities would need to be specific, such that the customer could enforce the promise if necessary. This would be the case when the promise is clearly defined in the contract or when the customer can objectively determine whether or not a good or service is transferred based on an entity's customary business practice. Paragraph 25 of the 2011 ED also explains that "performance obligations do not include activities that an entity must undertake to fulfil a contract unless the entity transfers a good or service to the customer as those activities occur." Accordingly, activities undertaken by the entity for only its own benefit do not transfer a good or service to a customer and, thus, would not represent a performance obligation. Furthermore, as explained in paragraph B37/IG37, "the promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer." This is

because those actions are merely part of the entity's representation that the asset is valid¹.

Step B – Applying the separation criteria

39. After identifying the other promised goods or services in the contract, an entity would then assess whether the license is distinct from the other promised goods or services in the contract by applying the separation criteria (paragraphs 28 and 29 of the 2011 ED, revised by tentative decisions of the Boards in July 2012). Thus, an entity would assess whether the customer can benefit from the good or service (ie the license) on its own or together with other readily available resources (paragraph 28(b) of the 2011 ED and tentative decision in July 2012).
40. Assessing whether the customer can benefit from the license may be difficult because often the customer can obtain *some* benefit from the transferred license on its own. However, for the customer to fully benefit from the license, the license may need to be combined with a service that is integral to the license and necessary for the customer to continue to benefit from the license for the period those rights are provided. This may include, for example, integral services, such as hosting, research and development, or the promise to provide critical updates that are a key element of the negotiated transaction between the entity and the customer. Additionally, the license may not be distinct if the license cannot be purchased without the service, or, if without the service, the benefit the customer receives from the license would be significantly (and adversely) affected.

Step C - When are the performance obligations satisfied?

41. To be able to recognise revenue, the entity must have satisfied its performance obligation by transferring a promised good or service to a customer (ie the entity has performed). As with other contracts and performance obligations, an entity would determine when the performance obligation is satisfied based on the

¹ This notion was included in Paragraph B37/IG37 of the 2011 ED and comes from paragraph 605-10-S99-1, SAB Topic 13.A.3. Delivery and Performance, item g. Deliverables within an arrangement.

criteria in paragraph 35 of the 2011 ED (performance obligations satisfied over time) or the indicators in paragraph 37 of the 2011 ED (performance obligations satisfied at a point in time). When the license is distinct, determining when the performance obligation is satisfied will depend on which view of the nature of an entity's promise outlined in paragraphs 11–34 above is tentatively decided by the Boards. However, when the license arrangement includes other promises and the license is not distinct, an entity would determine when the combined performance obligation is satisfied. Often, this combined performance obligation would include a service and, thus, would be satisfied over time. This is illustrated in an example in paragraph IG36/B36 of the 2011 ED; that is, revenue can be recognised over time for contracts that contain both a license and a service that represent a single performance obligation. In these cases, it is likely that the criterion in paragraph 35(b)(i) of the 2011 ED will be met because the entity's performance of those services associated with the licenses (a) will not create an asset with an alternative use and (b) will be simultaneously received and consumed by the customer.

42. The staff observe that because of its intangible nature, there may be cases where the entity performs before the customer can use and benefit from the license. This may occur, for example, when the entity delivers the intellectual property, such as software or movie rights, before the license term begins or before the customer can use the software or show the movie. In these cases, an entity would need to consider the customer's perspective to assess when control transfers (paragraph BC86) and, therefore, an entity may not be able to recognise revenue before the license term begins (paragraph B34/IG34). This is consistent with current guidance on revenue recognition for licenses.

Applying the constraint on revenue recognised

43. Although it is not related to determining when a performance obligation is satisfied, the application of the constraint to the promised consideration in a license arrangement may also affect the amount and timing of revenue recognition. This is because when the consideration is variable, the cumulative amount of revenue recognised is subject to a constraint that assesses the entity's

experience and ability to estimate such variable amounts (Agenda Paper 7B/164B considers improvements to these proposals). In addition, paragraph 85 of the 2011 ED indicates that if the promised consideration in a license arrangement “varies on the basis of the customer’s subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (ie when the customer’s subsequent sales occur).” In these cases, regardless of when control transfers to the customer and the entity has performed, the entity may only recognise revenue for the variable consideration over time, as the customer’s subsequent sales occur.

44. The staff note that no respondent noted disagreement with the outcome of applying paragraph 85 in the 2011 ED, however, some respondents disagreed with including this rules-based paragraph and recommended clarifying the principles in paragraphs 81-82 of the 2011 ED, rather than retaining the guidance in paragraph 85. Many respondents requested paragraph 85 be expanded to include other transactions with similar economic circumstances. Additionally, a number of respondents, primarily in the pharmaceutical, software, and technology industries, appreciated the clarity that paragraph 85 of the 2011 ED provided them in accounting for their licenses of intellectual property. These respondents cited the practical manner in which paragraph 85 achieves the outcome that these respondents think represents the economics of these transactions.
45. As a result of this feedback and the staff’s preliminary analysis, the staff have included the effect of the constraint and specifically paragraph 85 from the 2011 ED in the illustrative examples of license arrangements in Agenda Paper 7G/164G. Based on these examples, the staff observe that irrespective of the tentative decision of the Boards related to the nature of the promise related to the license (View A, B, or C above), paragraph 85 may directly affect the amount and timing of revenue recognised in license arrangements. For example, even if the Boards tentatively decide to adopt View C (ie the nature of the promise is to provide access), there may be some licenses that represent a sale of the intellectual property (thus, resulting in revenue being recognised at a point in time) which

may include promised consideration of a sales-based royalty. Given this, the staff think that the Boards should separately consider the application of paragraph 85, independent of any decisions made in this paper. Furthermore, the staff think that any decision on paragraph 85 should be considered in light of any tentative decisions on the operation of the constraint more broadly (see Agenda Paper 7B/164B). In light of those thoughts, the staff plan to bring the issue of paragraph 85 to the Boards at a future meeting.

Bringing it all together

46. As discussed above, the staff think that a license is a contractual mechanism that establishes the customer's rights and, therefore, the entity's obligations related to the intellectual property of the entity. Those rights and obligations can vary greatly and, thus, the term 'license' is often used to describe a broad range of transactions. The staff observe that license arrangements often include several other promises to perform services and/or transfer other assets. Therefore, similar to other contracts, the timing of the transfer of resources is affected by the assessment of the promises made, the determination of whether those promises represent separate performance obligations, and when those separate performance obligations are satisfied by the entity. Therefore, regardless of the path supported by the Boards regarding the views of the nature of the promise in a license, entities will be required to perform an assessment of the specific facts and circumstances in each license arrangement to determine the amount and timing of revenue recognition.
47. As discussed above (paragraphs 32-34), the staff recommend the Boards affirm the proposal in the 2011 ED and clarify that the nature of the promise in a license contract is a promise to provide a right to use, but not own, intellectual property of the entity (View A).
48. Additionally, the staff recommend that the Boards clarify the application of the overall model to license arrangements, thereby reinforcing the assessment that entities must perform for all license contracts, including assessing whether (a) the

entity has promised to transfer other goods or services in addition to the license, (b) whether the license is distinct and therefore separable from those other goods or services (c) when the license, goods or services or the bundle of such resources is transferred to the customer and, finally, (d) if the transaction price is subject to the constraint.

Questions for the Boards

1. Do the Boards agree with the staff recommendation (paragraphs 32-34), that the nature of the promise in a license contract is a promise to provide a right to use, but not own, intellectual property of the entity (View A, 2011 ED)? If not, what view do the Boards support and why?
2. Do the Boards agree that the implementation guidance for license should be clarified to illustrate the application of the revenue model to license arrangements (paragraphs 35-45)?

Appendix A: Suggested improvements to the 2011 exposure draft

A1. The following table lists the proposed requirements from the exposure draft that relate to the implementation guidance for licenses and identifies which of those proposals might change as a result of the staff recommendations in this paper.

Proposals from 2011 Exposure Draft	Suggested Improvements
<p>IG34. If an entity grants to a customer a license or other rights to use intellectual property of the entity, those promised rights give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights. Control of rights to use intellectual property cannot be transferred before the beginning of the period during which the customer can use and benefit from the licensed intellectual property. For example, if a software license period begins before the customer obtains an access code that enables the customer to use the software, an entity should not recognize revenue before the entity provides the access code.</p>	<p>Given the staff recommendation in paragraphs 32-34 that the nature of the entity's promise in a license is a promise to provide a right (ie View A and the 2011 ED proposals), the substance of this paragraph will not change materially. However, should the Boards tentatively decide View B or View C, this paragraph would be updated based on the description of the views in paragraphs 18-31.</p>
<p>IG35. To determine the amount of revenue recognized for transferring a license to a customer, the entity should apply the proposed guidance on determining and allocating the transaction price (including paragraph 85 on constraining the amount of revenue recognized to amounts that are reasonably assured).</p>	<p>No material change is anticipated.</p>
<p>IG36. If an entity has other performance obligations in the contract, the entity should apply the criteria in paragraphs 23–30 to determine whether the promised rights are a separate performance obligation or whether the performance obligation for the rights should be combined with those other performance obligations in the contract. For example, if an entity grants a license that is not distinct because the customer cannot benefit from the license without an additional service that the entity promises to provide, the entity should account for the combined license and service as a single performance obligation satisfied over time.</p>	<p>This paragraph will be refined based on the discussion in paragraphs 35-45.</p>
<p>IG37. If an entity has a patent to intellectual property that it licenses to customers, the entity may represent and guarantee to its customers that it has a valid patent and that it will defend and maintain that patent. That promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer. Defending a patent protects the value of the entity's intellectual property assets.</p>	<p>No material change is anticipated.</p>